Report by the
Comptroller and Auditor General

National Savings

Public-Private Partnership with Siemens Business Services

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Comptroller and Auditor General

National Audit Office
6 April 2000

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Front cover photograph by Doug Neal (National Audit Office)

Executive summary

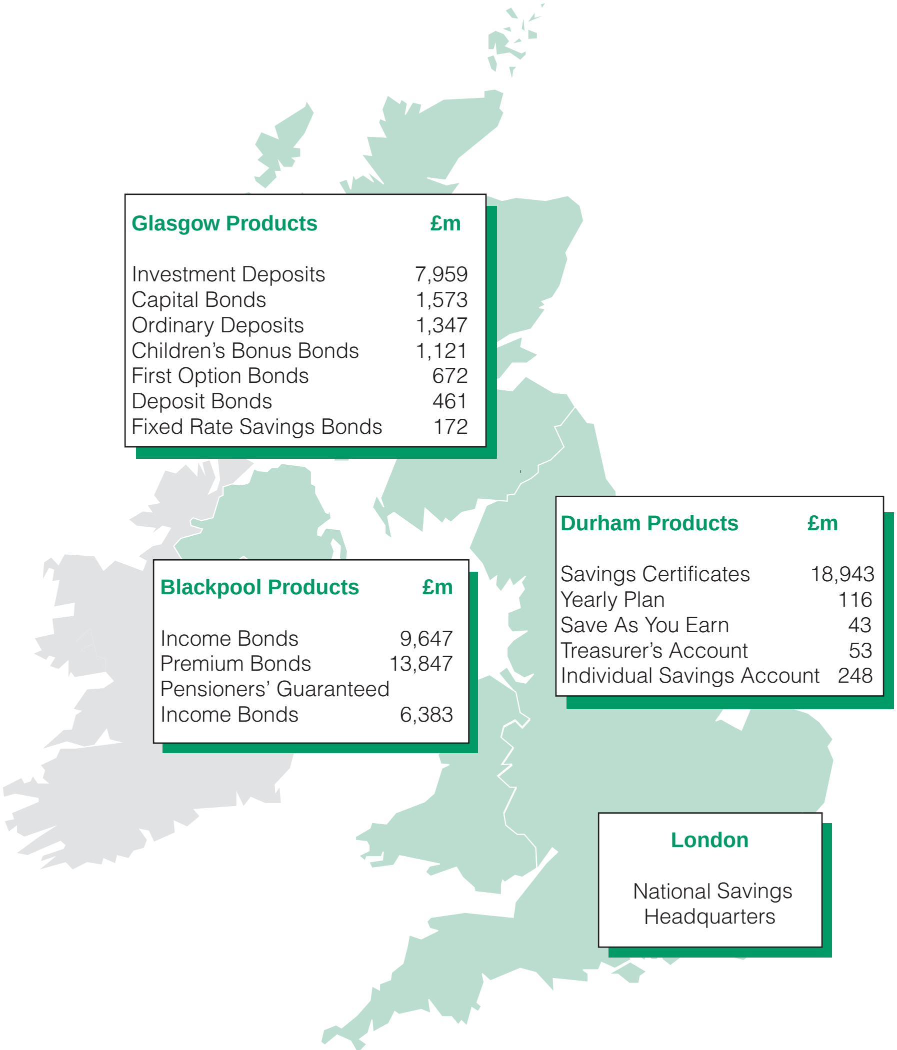
1 The Department for National Savings (National Savings) is an executive agency of the Chancellor of the Exchequer which helps to fund central government borrowing by offering savings products directly to the public. In March 1997, National Savings invited expressions of interest from potential bidders to run the operations required to process product transactions and provide a customer service (the operational service). Following a competition, National Savings transferred all of its operational staff and assets to Siemens Business Services (SBS) from 1 April 1999. Within a partnership framework, SBS will service all of National Savings' products for up to 15 years. The partnership forms a vital part of a programme of modernisation and transformation which aims to provide better value for the taxpayer and National Savings' customers. An intensive investment programme should enable National Savings to be competitive and relevant in the highly competitive and fast moving retail savings market.

2 National Savings has about 12 per cent of the retail savings market and at 31 March 2000 around 30 million customers had invested a total of £62,500 million in a range of products which include Premium Bonds, Savings Certificates and Investment Deposits. These products are serviced by SBS at three operational sites - Blackpool, Durham and Glasgow. National Savings is located mainly at its London headquarters (Figure 1). Business is conducted through agents and directly with customers by post and by telephone. During 1999-2000, the operational service processed over 50 million transactions resulting in sales of £10,200 million and repayments of £11,100 million. Although National Savings has a number of computer systems, many of the processes used for product transactions are paper based. Prior to April 1999, National Savings employed some 4,200 staff and incurred running costs of some £180 million a year.

3 We examined the value for money likely to be obtained by National Savings from the partnership with SBS, whether the contract underpinning the partnership will be an effective framework for managing the relationship and how the procurement process was handled. Our methodology is summarised at Appendix 1.

Figure 1

Amounts invested in National Savings' products at 31 March 2000



Source: National Savings

The partnership with SBS is capable of delivering significant benefits

The need for private sector involvement was based on a business strategy

4 The partnership with SBS arose from a strategy review which concluded that, although National Savings created significant added value for the taxpayer, it would be seriously eroded unless operational delivery was modernised to compete with private sector participants in the retail savings market. To meet the challenge, savings products needed to be designed and marketed more effectively, running costs had to be cut and customer service enhanced. This led to two key decisions.

5 First, a core of some 130 staff would be responsible for the design, management and marketing of products and for liaison with the Treasury on annual funding requirements. The remaining 4,100 staff would provide the operational service required to process transactions and deal with customers. Second, the private sector could provide the substantial investment needed to transform operational processes, design and implement supporting IT systems and create new jobs through the development of third party business.

Performance to date has been encouraging

6 Although it is impossible for us to reach a conclusion on the eventual success of this project at such an early stage, it is apparent that performance since the partnership began has been better than that of National Savings in the preceding period. In the first six months of the partnership, SBS has played a key role in the launch of three new products, along with five product variations. In comparison, only three new products had been introduced in the previous eight years.

It is a high risk project but SBS considers it is taking a low risk approach

7 With 30 million customers, a major failure of the operational service would be a matter of grave public concern. To meet National Savings' requirements and to achieve its expected returns on the project, SBS will have to transform the existing business processes, combined with a significant advance in information technology. These tasks involve a high degree of risk.

8 Two factors mitigate this risk. First, in contrast with SBS' existing contracts with the Passport Agency and the Immigration and Nationality Directorate, SBS is wholly responsible for new operational processes, supporting IT systems and their use by former National Savings' staff who have transferred under the deal. SBS therefore has more control over this project than on previous occasions, including the cultural change required from its new workforce. If SBS is unsuccessful, it will bear the financial consequences of failure. Second, as there is a system that works and can continue to work until new systems are up and running, SBS plan to change the business processes and supporting IT systems gradually, rather than taking a "big-bang" approach. Each stage, for the most part involving proven IT packages, is to be rolled out well in advance of contracted target dates, and small groups of operations staff will check usability and identify potential improvements.

9 As the transformation of business processes is central to the success of the partnership, National Savings is monitoring progress through an agreed governance structure and working-level contacts. Alongside this, National Savings has employed independent IT consultants to help it act as an intelligent customer when assessing SBS's proposals and progress.

Running costs will be lower

10 The estimated net present cost of running the operational service in-house was £793 million over 15 years, while the net present cost of the partnership with SBS is expected to be £635 million. The principal reasons for the difference are that SBS can invest cash in transforming operations more quickly than National Savings and can create new jobs through the development of third party work. National Savings' scope for investment was constrained by annual cash budgets, which were planned to decline in real terms at an annual rate of 2.5 per cent and it could not create new jobs for surplus staff. SBS and other bidders were not subject to such constraints and could plan to incur losses in the first years of the contract to realise efficiency gains more quickly than National Savings could.

The contract underpinning the partnership appears to be robust

The contract aligns the interests of both parties

11 SBS saw the acquisition of the operational service as a strategic asset which, with skilled and experienced staff already in place, provided an opportunity to develop services for other customers. Its bid was therefore priced to reflect the creation of at least 1,200 jobs on such third party work. If SBS is not successful in creating these new jobs, it will bear the costs of any potential redundancies.

12 Although SBS plans to use at least 1,200 staff on third party work, the contract price included a time-limited contingency of £45 million in the event that SBS was not as successful as expected in winning third party work. Any part of this contingency provision which is unused will be shared in a ratio of 70:30 between National Savings and SBS. Where SBS uses staff and other assets which remain employed on National Savings' business for third party work, National Savings will share in profits and receive rebates on running costs.

13 Within the contract price SBS is required to facilitate the introduction of four new products in each of the first two years and two new products in each subsequent year. But SBS is not guaranteed all the additional work needed to introduce new savings products. If National Savings enters new areas of business through the introduction of fundamentally different products or develops fundamentally different sales channels, SBS is required to assist National Savings in their design and development. However, to preserve the ability to use competition to get good value, the contract allows National Savings to go out to tender for the operations needed to deliver and maintain such products and channels. In addition to detailed sharing mechanisms covering specific aspects of the partnership, National Savings is also entitled to receive 50 per cent of the amount by which SBS's annual net profit margin exceeds an agreed percentage in the contract and will not share in losses.

The contract allocates risks properly

14 Although SBS has accepted significant risks, it considers that the transfer of the entire operational service under a long-term contract provides the power and necessary incentives to manage those risks. For instance, SBS is responsible for operational errors. If an overpayment is made to a customer, SBS has to reimburse National Savings and take action to recover the overpayment. If an underpayment occurs, National Savings bears no cost risk for any SBS errors but SBS will have to pay compensation to customers if sums due have been paid late and may, if too many underpayments are made, incur performance deductions. SBS must also bear the cost of all staff fraud and any customer fraud in any one year in excess of £250,000. There are, therefore, powerful incentives for SBS to limit the number of operational errors.

There is machinery to manage the contract

15 National Savings and SBS have established a joint governance structure for the contract. To help monitor the contract at a strategic level and on a day to day basis, National Savings has established a relationship management unit which includes professionally qualified senior staff who negotiated the contract. The unit has developed a manual of new business management processes and has introduced new business reports to help ensure that management of the partnership is effective.

16 In addition to the transformation of operations and the introduction of new products, SBS has to meet and exceed 42 key performance indicators spread across eight areas of operational services, designed to measure accuracy, timeliness and quality of service to customers. To monitor SBS's reporting of performance satisfactorily, National Savings has increased the resources it devotes to these tasks and plans a further small increase.

17 The contract includes a comprehensive list of events which can lead to default. In particular, poor performance by SBS can lead to default and termination of the contract. National Savings may also terminate the contract for any reason after the first two years but must give 12 months notice and pay compensation if SBS is not at fault.

18 In such a long contract it is inevitable that there will be constant changes as the business environment, market place and technology move forward. Formal change processes have been put in place to manage and control this. Accordingly, both partners have agreed roles and responsibilities within their respective organisations to facilitate the agreement of contract changes. It is also essential to include clear arrangements to apply at the end of the contract period or earlier termination, so that National Savings are free to choose an alternative supplier through a competitive process. In a pre-handback period, one year before expiry of the contract, SBS cannot alter the terms of employment of staff, dispose of any assets or alter key contracts with suppliers. During the contract, where assets are shared, SBS and National Savings must jointly agree the appropriateness of third party business proposals and maintain the transferability of assets at the end of the contract.

19 Nevertheless, to the extent that SBS succeeds in winning significant amounts of third party business, a proportion of staff and assets may well be employed on both National Savings and third party work. Without proper control, the detailed handback procedures which are included in the contract may not work well. It is therefore important that the contract should be varied (using agreed change procedures) to ensure that the handback provisions remain workable.

The procurement process was handled well

The procurement was properly planned

20 As a substantial part of its operations would be transferred to the private sector, senior National Savings' management committed a large amount of time to planning the project. Bidders were consulted to establish the likely benefits from a partnership and how the procurement could best be implemented. To maximise the potential for efficiencies, National Savings agreed that the operational service should be transferred as a single package to a single private sector provider under a long-term contract.

21 To protect itself from being reliant on a single partner in a long-term contract, National Savings sought firm prices for each year of the contract, depending on forecast transaction volumes. During the life of the contract, costs and quality would be benchmarked at regular intervals with the outcomes limited to downward only price movements and/or improvements in quality of service. In addition, National Savings required a partner to share equally any higher than expected profits.

The detailed requirements of the project were well specified

22 National Savings clearly defined the scope of its own responsibilities and those of a private sector partner. A private sector partner would be responsible for service delivery and development, support services and database management. In setting a detailed output specification, National Savings paid particular attention to the handling of volume risk and the use of a performance measurement regime to provide appropriate incentives for high service quality.

There was competition at each stage of the process

23 Ninety companies responded to an advertisement published in the Official Journal of the European Communities in March 1997. National Savings selected four companies to receive an Information Memorandum setting out the scope of the project in greater depth. Following evaluation of the bidders' proposals, SBS and Electronic Data Systems (EDS) were invited to negotiate on detailed terms. National Savings considered that taking forward two rather than three or all four of the bidders would provide the optimum balance between the maintenance of competitive tension in the final stage of bidding and the significant costs for both sides in formulating and evaluating final bids. National Savings maintained competitive pressure on SBS and EDS by negotiating a draft contract with each of them before recommending a preferred bidder to the Treasury. At each stage of the procurement, pre-determined criteria were used to evaluate bids. SBS provided better value for money than EDS on the basis of price and the extent of risk transfer. This was most apparent in the higher limits of liability and level of performance deductions SBS was prepared to accept.

Lessons learned

24 Although it is too early to conclude whether the key outcomes envisaged in this partnership will be achieved, it is apparent from our examination that National Savings secured a very good deal with SBS. In doing so, a range of complex issues had to be addressed and National Savings' experience underscores some important lessons which should be borne in mind in negotiating public-private partnerships.

Take a pragmatic approach

a) **There are advantages in transferring not only the risk of business process re-engineering involving IT solutions to a private sector partner but also the staff who will be responsible for implementing those solutions.**

SBS is responsible for new IT systems and their use by staff who have transferred under the deal. SBS therefore has more control over this project than on previous projects, including the cultural change required from its new workforce (paragraphs 1.23 to 1.26).

b) **In transferring staff to the private sector in circumstances where they may otherwise be made redundant, departments should encourage bidders to make proposals for alternative work for their new employees.**

SBS saw the acquisition of the operational service as a strategic asset which provided an opportunity to develop services for other customers. Its bid was therefore priced to reflect the creation of at least 1,200 jobs on such third party work (paragraph 2.2(a)).

c) **It is unwise to rely solely on risk transfer and appropriate incentives for the private sector party to ensure that the required services will be delivered.**

As the transformation of operational processes is central to achieving the benefits expected by each partner and the ultimate success of the partnership, National Savings is monitoring progress by SBS and has engaged independent IT consultants to help it act as an intelligent customer (paragraphs 2.9 and 1.28).

d) **Departments should ensure that poor performance by a service provider will put the contract at risk of termination**.

National Savings has avoided being "locked-in" to the contract and can terminate the partnership if performance standards agreed with SBS are not achieved (paragraphs 2.11 to 2.13).

Maintain and monitor the contract terms

e) Departments should ensure that they have appropriate management resources to monitor the performance of a private sector partner.

SBS has to meet and exceed 42 key performance indicators spread across eight areas of operational services, designed to measure accuracy, timeliness and quality of service. National Savings has increased the resources it devotes to monitoring SBS's performance and aims, through effective business judgement, to incentivise performance improvement rather than apply a mechanistic formula of penalties (paragraph 2.10).

f) In entering into a long-term partnership, departments must ensure that the underlying contract reflects changes which will occur over time.

Detailed procedures have been agreed to facilitate the agreement of changes and incorporate them in the contract. Nevertheless, if SBS succeed in winning significant third party business, a proportion of staff and other assets may well be employed on both National Savings and third party work. It is therefore important that the contract should be varied using these agreed procedures so that the provisions for handing back staff and assets remain workable (paragraphs 2.16 to 2.18).

Managing the procurement process

g) Senior departmental management should be closely involved.

As a substantial part of its operations would be transferred to the private sector, senior management within National Savings took control of the project and, with the support of professional and experienced staff, committed a large amount of time to planning the procurement and agreeing the terms of the contract with SBS (paragraphs 3.2 and 3.3).

h) Departments will be in a much stronger negotiating position if the content and scope of the deal is made clear to bidders.

National Savings clearly defined its own responsibilities and those of a private sector partner at the Invitation to Negotiate stage of the procurement process. There were considerable benefits in sending out a properly constructed Invitation to Negotiate and it is questionable whether National Savings would have got such a good deal if the document had been issued on the date originally intended. Throughout the procurement, pre-determined criteria were used to evaluate bids. To avoid any drift on price, risk transfer and value generally, competitive pressure was maintained on two final bidders by negotiating a draft contract with each of them before recommending a preferred bidder to the Treasury (paragraphs 3.8 to 3.16).